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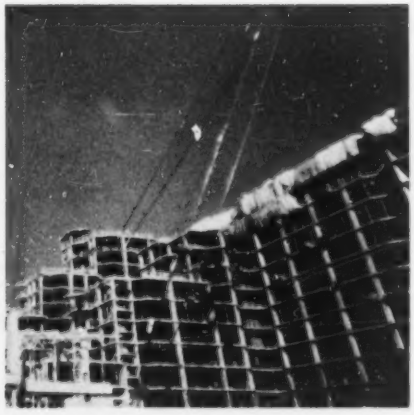
1986 Dodge/Sweet's Construction Outlook

Second Update
July 1986



Are We There Yet?

An ominous gap has opened up between construction contracting—the industry's indicator of *future* construction and building products demand—and the various measures of *current* performance. Current construction activity (construction put in place, building materials shipments, employment in construction) all remained strong through 1986:I and, after more than three years of cyclical expansion, market activity was still reaching for a new peak. Contracting for new projects, on the other hand, slowed almost to a standstill in 1985:IV and then declined a sharp 7 percent in the opening quarter of 1986.

This is exactly the kind of lead-lag behavior to expect at the upper turning point of the building cycle. Yet, with the marketplace as politicized as it is by issues like tax reform and deficit reduction, the recent divergence of the basic construction indicators could be a false alarm.

The recent weakness in contracting for new construction—the key to the demand for building products during the second half of 1986—may not be as threatening as the first quarter's 7 percent decline implies. Uncertainty about the consequences of tax reform proposals on real estate development and on local public works financing could explain much of the volatility in contracting for nonresidential construction since 1986 began. It is reasonable to expect that a substantial number of commercial and public projects which might ordinarily have gone ahead during the first quarter were put "on hold" awaiting clarification of the tax issue. If so, a strong—although temporary—rebound might logically follow. An improved rate of contracting early in the second quarter supports this interpretation of events.

In the midst of the volatility that is being superimposed on the building cycle by political events in 1986, it is a good idea to keep a few things in mind:

- Commercial and industrial building passed its peak before 1985 ended, and the overbuilt office component is highly vulnerable to steep decline.
- Public works construction, lacking the support of Federal programs, is increasingly dependent on local government financing.
- Housing, responding to lower interest rates, is the main source of support for the construction market in 1986.

An Economic Scenario For 1986 And 1987

One of the few good things that can be said about an extended period of "semi-prosperity" such as the economy has experienced since 1983 is that there's still plenty of room for more growth. Excess capacity abounds, and none of the usual bottlenecks (shortages, wage price stress, other imbalances) that often signal the conclusion of a period of cyclical upswing are evident. In the absence of reasons to the contrary, conventional wisdom insists that expansion will just keep rolling along. But mere room for expansion is not enough. Where will next year's growth come from?

Not from the public sector. With mandatory deficit reduction the law of the land, the net effect of fiscal policy (spending and taxing combined) will amount to "fiscal drag." The Treasury will be taking more out of the economy's spending stream—relative to last year—than it will put in. State and local governments will provide a modest stimulus as they try to fill the widening gaps in Federal domestic programs, but as a whole, the public sector will be close to neutral as a source of growth for the next few years.

Not the business sector, either. McGraw-Hill's latest survey of capital spending plans confirms the obvious. With more capacity on hand than needed, and facing the loss of tax in-

centives for investment, the industrial community plans to stand pat for the next several years until factory output catches up with its recent capital spending binge. But until rising exports begin to close the trade gap, the manufacturing sector is locked into sluggish growth.

If current (May 1986) plans materialize, investment in plant and equipment will be virtually unchanged for three years at a level slightly below that of 1985.

A consumer-led expansion, then? The dependability of the consumer is, on one hand, the basis for continued expansion of total economic growth for the next couple of years. But lacking the support of either the public or business sectors, it is also the basis for a ceiling on growth of 3 percent per year or less.

The consumer sector is usually considered to be relatively passive, spending and saving reasonably steady proportions of its disposable income. As this happens, the consumer's contribution to the economy's growth is limited by the combination of employment and productivity, averaging between 2½ and 3 percent per year (in constant dollars). In 1986, consumer spending is increasing by close to 3 percent (one of the better years), and is likely to hold within the range of 2½ to 3 percent for the near future.

A more volatile form of consumer behavior—investment in housing—is helping the economy to do a little better in 1986 than its sluggish 1985 pace, however. In this year's favorable mortgage environment, homebuilding is currently adding some spark to an otherwise rundown Gross National Product with a 10 percent advance.

The Outlook At Mid-1986

NONRESIDENTIAL BUILDING: As it has for several years, *office building* will continue to dominate the near-term outlook for the nonresidential sector. From here on, however, office building will be restraining the market instead of driving it upward.

No construction market is more out of balance—and therefore more vulnerable—than offices. The "building boom that stayed too long" has left behind it a surplus of office space that is pushing the national vacancy rate toward 20 percent. Accelerated depreciation has been a major stimulus since 1982, but tax reform will soon be removing a lot of the incentive to build empty office buildings. In fact, the adjustment to overbuilding has already begun—in advance of tax reform.

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		1985 Actual	1986 Forecast	Percent Change 1986/85
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	342	265	– 23
	Stores & Other Commercial	592	570	– 4
	Manufacturing Buildings	154	135	– 12
	Total Commercial & Manufacturing	1,088	970	– 11
	Educational	100	100	—
	Hospital & Health	71	70	– 1
	Other Nonresidential Buildings	136	137	+ 1
	Total Institutional & Other	307	307	—
	Total Nonresidential Buildings	1,395	1,277	– 8
Contract Value (millions of dollars)	Office Buildings	$ 24,674	$ 20,075	– 19
	Stores & Other Commercial	22,771	22,550	– 1
	Manufacturing Buildings	7,472	6,775	– 9
	Total Commercial & Manufacturing	$ 54,917	$ 49,400	– 10
	Educational	$ 8,810	$ 8,975	+ 2
	Hospital & Health	7,629	7,675	+ 1
	Other Nonresidential Buildings	10,894	11,125	+ 2
	Total Institutional & Other	$ 27,333	$ 27,775	+ 2
	Total Nonresidential Buildings	$ 82,250	$ 77,175	– 6
Residential Buildings				
Dwelling Units* (thousands of units)	One-Family Houses	961	1,150	+ 20
	Multi-Family Housing	836	700	– 16
	Total Housekeeping Residential	1,797	1,850	+ 3
Floor Area (millions of square feet)	One-Family Houses	1,506	1,800	+ 20
	Multi-Family Housing	795	668	– 16
	Nonhousekeeping Residential	102	88	– 14
	Total Residential Buildings	2,403	2,556	+ 6
Contract Value (millions of dollars)	One-Family Houses	$ 69,039	$ 85,200	+ 23
	Multi-Family Housing	32,080	27,825	– 13
	Nonhousekeeping Residential	7,125	6,450	– 9
	Total Residential Buildings	$108,244	$119,475	+ 10
Nonbuilding Construction				
Contract Value (millions of dollars)	Transportation-Related Construction	$ 24,868	$ 24,450	– 2
	Water-Related Construction	12,936	12,825	– 1
	Total Public Works	$ 37,804	$ 37,275	– 1
	Utilities	$ 2,472	$ 2,500	+ 1
	Total Nonbuilding Construction	$ 40,276	$ 39,775	– 1
All Construction				
Contract Value (millions of dollars)	Total Construction	$230,770	$236,425	+ 2
	Dodge Index (1977 = 100)	164	168	

*F.W. Dodge basis

The peak of contracting for offices—an annualized rate of 346 million square feet—was reached in 1985:II. By 1986:I volume had been cut back to 275 million square feet, but this rate of building was still excessive in view of the accumulation of surplus space. Since most of the decline to date has been concentrated in the Southwest (where vacancy rates of 30 percent are not uncommon), it would appear that local market imbalance, and not the impending extension of depreciation through tax reform, was the primary motive for the cutback over the past few quarters. This suggests that still deeper declines lie ahead when tax reform adds an extra dimension to the problem. A decline of nearly 25 percent in 1986 to an estimated 265 million square feet will be only the beginning of an extended correction that will require the absorption of as much as 250 million square feet of excess space over the next several years.

1986 Regional Estimates
Dodge Construction Potentials

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Northeast — CT, ME, MA, NH, NJ, NY, PA, RI, VT

Contract Value (millions of dollars)

	1985 Actual	1986 Forecast	Percent Change 1986/85
Nonresidential Buildings			
Commercial and Manufacturing	$ 8,312	$ 7,750	− 7
Institutional and Other	4,663	4,775	+ 2
Total	$12,975	$12,525	− 3
Residential Buildings			
One-Family Houses	$11,427	$15,125	+32
Multi-Family Housing	5,520	5,150	− 7
Nonhousekeeping Residential	1,034	1,000	− 3
Total	$17,981	$21,275	+18
Nonbuilding Construction			
Transportation-Related Construction	$ 4,852	$ 4,750	− 2
Water-Related Construction	2,147	2,250	+ 5
Utilities	437	475	+ 9
Total	$ 7,436	$ 7,475	+ 1
Total Construction	$38,392	$41,275	+ 8

South — AL, AR, DE, DC, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV

Contract Value (millions of dollars)

	1985 Actual	1986 Forecast	Percent Change 1986/85
Nonresidential Buildings			
Commercial and Manufacturing	$22,030	$19,350	−12
Institutional and Other	10,303	10,550	+ 2
Total	$32,333	$29,900	− 8
Residential Buildings			
One-Family Houses	$29,453	$33,925	+15
Multi-Family Housing	12,470	9,950	−20
Nonhousekeeping Residential	2,617	2,500	− 4
Total	$44,540	$46,375	+ 4
Nonbuilding Construction			
Transportation-Related Construction	$ 9,309	$ 9,000	− 3
Water-Related Construction	5,263	5,100	− 3
Utilities	601	700	+16
Total	$15,173	$14,800	− 2
Total Construction	$92,046	$91,075	− 1

North Central — IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI

Contract Value (millions of dollars)

	1985 Actual	1986 Forecast	Percent Change 1986/85
Nonresidential Buildings			
Commercial and Manufacturing	$10,482	$ 9,700	− 7
Institutional and Other	5,735	5,725	—
Total	$16,217	$15,425	− 5
Residential Buildings			
One-Family Houses	$10,556	$14,250	+35
Multi-Family Housing	4,670	4,450	− 5
Nonhousekeeping Residential	1,106	1,025	− 7
Total	$16,332	$19,725	+21
Nonbuilding Construction			
Transportation-Related Construction	$ 5,966	$ 5,975	—
Water-Related Construction	2,617	2,675	+ 2
Utilities	298	350	+17
Total	$ 8,881	$ 9,000	+ 1
Total Construction	$41,430	$44,150	+ 7

West — AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY

Contract Value (millions of dollars)

	1985 Actual	1986 Forecast	Percent Change 1986/85
Nonresidential Buildings			
Commercial and Manufacturing	$14,093	$12,600	−11
Institutional and Other	6,632	6,725	+ 1
Total	$20,725	$19,325	− 7
Residential Buildings			
One-Family Houses	$17,603	$21,900	+24
Multi-Family Housing	9,420	8,275	−12
Nonhousekeeping Residential	2,368	1,925	−19
Total	$29,391	$32,100	+ 9
Nonbuilding Construction			
Transportation-Related Construction	$ 4,741	$ 4,725	—
Water-Related Construction	2,909	2,800	− 4
Utilities	1,136	975	−14
Total	$ 8,786	$ 8,500	− 3
Total Construction	$58,902	$59,925	+ 2

Industrial construction won't be filling the void left by office building—at least not for a while. Contracting for manufacturing facilities bogged down at a weak 150 million square feet as long ago as mid-1984. It was no coincidence that 1984 was the year that the trade gap opened wide, domestic production stalled, and capacity utilization began to slip backwards. More recently, this general condition of excess capacity has been aggravated by the oil price war, leading to deeper cuts in the capital budgets of petroleum companies.

Latest capital spending plans of U.S. manufacturers show an intent to hold investment in plant and equipment at last year's level until rising output takes up some of the slack. However, even that minimal goal isn't likely to be met in 1986 when contracting for industrial construction has been averaging only a weak 120 million square feet through most of the first half of the year.

Retail building is the exception to the otherwise sagging commercial and industrial construction market. In response to the current high rate of home-building, the demand for stores and warehouses should be *stronger* in the second half of 1986. And with allowance for the typical lag between residential and retail building, 1987's first half should remain strong.

The potential for improvement of store and warehouse contracting in the sec-

ond half of 1986 will not, by itself, be enough to sustain total commercial and industrial building at last year's peak rate. The sharp break in office building and slippage in manufacturing building will dominate the commercial and industrial market, causing contracting to recede from its 1985 peak of 1,088 million square feet to 970 million, a decline of 11 percent. The continuing retreat of office building will be the main reason for a further reduction of total commercial and industrial building to just under 900 million square feet in 1987.

The underlying demand for *institutional buildings* (the balance of the nonresidential sector), is geared to demographics which are gradually becoming more favorable. However, short-run financial support for the construction of schools, health care facilities, and public administration buildings faces a mixed future. Municipal bonds, the major source of funding for schools and hospitals, will survive tax reform and retain their traditional tax free status, but the scheduled expiration of General Revenue Sharing in 1987 will put a $4 billion plus dent in the budgets of local governments.

In this environment of trade-offs, 1986 (and 1987) contracting for institutional building should hold close to last year's volume—between 300 million and 310 million square feet per year.

With commercial and industrial building facing an extended cyclical decline, the stabilizing influence of institutional building will limit the fall of *total* nonresidential building to 1,277 million square feet in 1986, a decline of 8 percent. In 1987, circumstances will be leading to an even lower volume of contracting.

PUBLIC WORKS CONSTRUCTION: Construction of transportation and environmental facilities provides the infrastructure that supports all residential, commercial, and institutional building. Here the risk is stagnation at an inadequate level due to the scarcity of public (especially Federal) funds.

The prospect of continuing budgetary restraint on public programs is often aggravated by temporary "crises." In the first quarter of 1986, contracting dipped sharply due to unsettled conditions in the municipal bond market. A second quarter rebound, followed by a steadier rate of contracting during the remainder of the year, will nevertheless leave the 1986 total slightly below 1985's level.

Apart from such short term interruptions of funding, the need to adapt to the enduring constraints of Federal deficit reduction and the shift to local funding will keep public works construction at a disadvantage for several years. Compliance with Gramm-Rudman deficit targets has led to a freeze on Federal funds available in 1986 for major construction programs. In 1987, the combination of deeper Federal budget cutting and the termination of General Revenue Sharing will leave more of a financial void than state and local governments can make up. As a result, contracting for public works construction appears headed for a steeper decline next year.

RESIDENTIAL BUILDING: If the Federal priorities of deficit reduction and tax reform seem to be casting a dark cloud over the *non*residential construction market, there's a silver lining. By providing the opportunity for more flexibility in monetary policy, deficit reduction could offset the upward pull on interest rates that will be coming from renewed inflation in the years ahead. The result: mortgage rate stability, and a sustained high level of homebuilding.

How much housing will mortgage rate stability close to 10 percent bring forth? Some optimists are forecasting as high as 2.0 million housing starts in 1986 and almost as many in 1987. The consensus of forecasters clusters closer to 1.9 million units this year, followed by 1.8 million next year. For several reasons, a slightly more conservative 1.85 million units in 1986 and 1.75 million in 1987 seems more credible.

- After three years of housing output of better than 1.7 million units, it is hard to make a case for a large backlog of pent-up demand. Demographics of the mid-1980's, when household formation is averaging approximately 1.4 million per year, imply that *total shelter* demand (including replacements) does not exceed 2.0 million units. Of this total, more than 200,000 units of demand are met by manufactured/mobile homes, leaving a net demand for conventionally built units of 1.7 to 1.8 million annually.
- The benefits of "low" mortgage rates will be confined largely to single-family building, where a gain of as much as 20 percent is anticipated this year. Multi-family housing, which is vulnerable to the loss of accelerated depreciation through tax reform, is more likely to be down than up in 1986 as the apartment "tax shelter market" loses its appeal.
- The "oil patch" won't deliver in 1986. The last time that housing starts reached 2 million units (1978), the West South Central region (Texas and surrounding states) provided nearly 300,000 of them. However, considering its depressed energy-based economy, this region isn't likely to deliver 200,000 units in 1986. Even though the South Atlantic area (Florida, etc.) is headed for record volume this year, the South as a whole, which typically accounts for 45 to 50 percent of national housing volume, will fall short of last year's housing output in 1986.

Despite these limitations, the forecast of 1,150,000 one-family units and 700,000 multi-family units (F. W. Dodge basis) in 1986 still adds up to the best housing year so far in the 1980's. In 1987, one-family starts will nearly equal the strong 1986 total, but with tax reform in full effect, multi-family building will decline further.

Develop A Strategy For Cyclical Decline

After more than three years of cyclical expansion, the building market is highly vulnerable to reversal. For the time being, newfound strength in residential building is concealing some fundamental weakness in nonresidential construction. However, the booming housing market has little room for further improvement, and the handicaps of deficit reduction and tax reform will soon be brought to bear on public and commercial construction. As this happens, the present tenuous balance of strength and weakness will give way to the declining phase of the building cycle—by 1987, if not before. More about this in October.

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Winding Down

Some measures of construction activity show that cyclical decline is already under way. Other measures are saying that decline is imminent, but hasn't quite happened yet. Which to believe? All of them. Like the proverbial ocean liner, the construction market takes plenty of time turning around.

Contracting for new construction—the industry's leading indicator—reached its peak almost a year ago (1986:II), concluding four years of continuous expansion. During the second half of last year, as the volume of new project starts slackened, measures of *ongoing construction* activity (construction put in place, shipments of building products, employment in construction) began to stabilize, indicating that the turnaround had reached its second stage. As more of last year's high volume of newly started work is brought to completion, this year's diminishing flow of new projects that replaces it will bring the third and last stage of reversal—a shrinking "inventory" of construction work in progress.

The Anatomy Of Decline

Whether you look at the construction market regionally or by building type, it is apparent that the decline of construction contracting since 1986:II has been selective rather than across-the-board. So far, the weakness has been confined largely to the South (−5 percent) and the West (−4 percent). By contrast, the Northeast and North Central regions were still holding even with last year's peak rate of construction contracting through the first quarter of 1987.

A comparison of building types shows a similar mixture of weakness and strength. Two categories—commercial/industrial building and multifamily housing—led the market into cyclical decline in 1986. At the same time, institutional building and public works construction made small gains. Most important, one family homebuilding flourished in last year's environment of falling mortgage rates.

The early months of 1987 brought more of the same. Total construction contract value continued to shrink in the first quarter as public works projects joined the casualty list, but sustained strength in homebuilding still made the difference between a gentle letdown and something worse.

First quarter 1987 contracting data are as significant for what did NOT happen as for what did. Anyone looking for the sudden collapse of commercial building because tax reform took effect at the beginning of the year won't find it in January's and February's statistics. That's because the adjustment to the new tax code has been taking place all through the past year in the form of steadily diminishing construction—especially of offices. And there's more to come.

A New Look At 1987

The outlook for construction activity in 1987 and beyond concerns a balance of opposing market forces:

- *The politics* of the marketplace are repressive. Last year's legislation mandating tax reform and deficit reduction has altered the environment for commercial building and for public works construction, requiring adaptation to austerity. Besides that...
- *The economy's future* is shaky. Forecasts that extend last year's 2½ percent real growth through 1987 rest upon bold assumptions about a reversal of trade that may be unrealistic. The options: at best more substandard growth; otherwise, stagnation. On the brighter side...
- *Interest rates* are likely to remain near their low current level for at least another year. No other single influence on construction activity is as important as credit. In addition...

- *Demographic support* is emerging for certain categories of building. The Fifties generation has reached the age of home ownership, and their children are entering school.

These are some of the events that will mold the contour of the other side of the building cycle. In last October's *Outlook*, it was concluded that offsetting positive and negative market forces at work in 1987 would limit the decline of total construction—in constant dollars—to approximately 5 percent below the 1986 peak. An estimated 3 percent rise of construction costs this year would hold the loss to only 2 percent in current dollars.

That evaluation still stands, although 1987 will be only the beginning of a period of cyclical decline spanning several years.

A Three-Way Market

A 2 percent decline from the 1986 peak of construction contracting doesn't sound very threatening. It must be appreciated, however, that a relatively thin slice of the construction market (the "tax shelter" group) will bear a very large part of that decline. At the same time, as much as half of total construction activity will be supported at or above its 1986 level of contracting as long as interest rates remain reasonably steady. The rest of the construction market (approximately one-fourth) doesn't have a convenient label such as "tax sheltered" or "credit sensitive." For a variety of reasons, this remaining group will be showing a moderate decline in 1987.

This unconventional grouping of construction categories (in place of the usual nonresidential/residential/nonbuilding classifications) offers the advantage of focusing on risks vs. potentials.

The High Risk Group

The two categories of construction most affected by tax reform—offices and apartments—have already revealed their vulnerability. These "tax shelter" markets, both vastly overbuilt during the five years following the Economic Recovery Tax Act, reached their peaks in 1985. Even before tax reform brought the arithmetic of real estate development back to reality, soaring vacancy rates had ordained the boom's end. In 1986, contracting for offices declined 13 percent, and multifamily housing was cut back 6 percent. It was only the beginning.

Because the reduced 1986 levels of contracting for offices and apartments were still much too high to make a dent in the oppressive vacancy rates that prevail in those two markets, further declines are needed to restore supply/demand equilibrium appropriate to the post-ERTA period. It is expected that office building, which declined from its 1985 peak of $24.9 billion to $21.9 billion in 1986, will ease another 18 percent in 1987 to $17.8 billion, on its way to a low of about $13 billion by 1989. Similarly, multifamily housing, which retreated from its 1985 peak of $32.6 billion to $30.6 billion in 1986, will decline another 18 percent in 1987 to $25.2 billion. One more year (1988) at this reduced level of contracting should eliminate most of the surplus apartment space now on the market.

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		1986 Actual	1987 Forecast	Percent Change 1987/86
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	285	225	– 21
	Stores and Other Commercial	572	525	– 8
	Manufacturing Buildings	142	140	– 1
	Total Commercial and Manufacturing	999	890	– 11
	Educational	117	115	– 2
	Hospital and Health	73	72	– 1
	Other Nonresidential Buildings	142	143	+ 1
	Total Institutional and Other	332	330	– 1
	Total Nonresidential Buildings	1,331	1,220	– 8
Contract Value (millions of dollars)	Office Buildings	$ 21,768	$ 17,825	– 18
	Stores and Other Commercial	22,975	21,775	– 5
	Manufacturing Buildings	6,548	6,700	+ 2
	Total Commercial and Manufacturing	$ 51,291	$ 46,300	– 10
	Educational	$ 10,565	$ 10,800	+ 2
	Hospital and Health	7,810	7,900	+ 1
	Other Nonresidential Buildings	11,869	12,200	+ 3
	Total Institutional and Other	$ 30,244	$ 30,900	+ 2
	Total Nonresidential Buildings	$ 81,535	$ 77,200	– 5
Residential Buildings				
Dwelling Units (thousands of units*)	One Family Houses	1,082	1,130	+ 4
	Multifamily Housing	737	585	– 21
	Total Housekeeping Residential	1,819	1,715	– 6
Floor Area (millions of square feet)	One Family Houses	1,730	1,800	+ 4
	Multifamily Housing	719	570	– 21
	Nonhousekeeping Residential	100	89	– 11
	Total Residential Buildings	2,549	2,462	– 3
Contract Value (millions of dollars)	One Family Houses	$ 83,219	$ 89,525	+ 8
	Multifamily Housing	30,615	25,200	– 18
	Nonhousekeeping Residential	7,281	6,700	– 8
	Total Residential Buildings	$121,115	$121,425	—
Nonbuilding Construction				
Contract Value (millions of dollars)	Transportation Construction	$ 25,110	$ 24,150	– 4
	Environmental Construction	13,860	14,325	+ 3
	Total Public Works	$ 38,970	$ 38,475	– 1
	Utilities	$ 2,107	$ 2,000	– 5
	Total Nonbuilding Construction	$ 41,077	$ 40,475	– 1
All Construction				
Contract Value (millions of dollars)	Total Construction	$243,727	$239,100	– 2
	Dodge Index (1982 = 100)	155	152	

*F.W. Dodge basis

1987 Regional Estimates
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Northeast (CT, MA, ME, NH, NJ, NY, PA, RI, VT)	1986 Actual	1987 Forecast	Percent Change 1987/86
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$ 9,194	$ 8,625	− 6
Institutional and Other	4,956	4,975	—
Total	$14,150	$13,600	− 4
Residential Buildings			
One Family Houses	$14,197	$15,825	+11
Multifamily Housing	5,945	5,225	− 12
Nonhousekeeping Residential	1,197	1,100	− 8
Total	$21,339	$22,150	+ 4
Nonbuilding Construction			
Transportation	$ 5,194	$ 4,925	− 5
Environmental	2,432	2,425	—
Utilities	451	425	− 6
Total	$ 8,077	$ 7,775	− 4
Total Construction	$43,566	$43,525	—

South (AL, AR, DE, DC, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV)	1986 Actual	1987 Forecast	Percent Change 1987/86
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$18,213	$15,725	−14
Institutional and Other	11,742	11,675	− 1
Total	$29,955	$27,400	− 9
Residential Buildings			
One Family Houses	$32,740	$33,725	+ 3
Multifamily Housing	9,796	7,300	− 25
Nonhousekeeping Residential	2,629	2,350	− 11
Total	$45,165	$43,375	− 4
Nonbuilding Construction			
Transportation	$ 9,445	$ 9,200	− 3
Environmental	5,196	5,500	+ 6
Utilities	479	500	+ 4
Total	$15,120	$15,200	+ 1
Total Construction	$90,240	$85,975	− 5

North Central (IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI)	1986 Actual	1987 Forecast	Percent Change 1987/86
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$10,917	$10,275	− 6
Institutional and Other	6,198	6,550	+ 6
Total	$17,115	$16,825	− 2
Residential Buildings			
One Family Houses	$14,207	$16,525	+16
Multifamily Housing	5,220	4,450	− 15
Nonhousekeeping Residential	1,189	1,300	+ 9
Total	$20,616	$22,275	+ 8
Nonbuilding Construction			
Transportation	$ 5,512	$ 5,325	− 3
Environmental	3,407	3,375	− 1
Utilities	283	275	− 3
Total	$ 9,202	$ 8,975	− 2
Total Construction	$46,933	$48,075	+ 2

West (AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY)	1986 Actual	1987 Forecast	Percent Change 1987/86
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$12,967	$11,675	−10
Institutional and Other	7,348	7,700	+ 5
Total	$20,315	$19,375	− 5
Residential Buildings			
One Family Houses	$22,075	$23,450	+ 6
Multifamily Housing	9,654	8,225	− 15
Nonhousekeeping Residential	2,266	1,950	− 14
Total	$33,995	$33,625	− 1
Nonbuilding Construction			
Transportation	$ 4,959	$ 4,700	− 5
Environmental	2,825	3,025	+ 7
Utilities	894	800	− 11
Total	$ 8,678	$ 8,525	− 2
Total Construction	$62,988	$61,525	− 2

Supportive Markets

For the time being, several important construction markets—including one family housing, institutional buildings, and environmental construction—will remain supportive in the sense that their exposure to decline in 1987 is minimal. Their potential for increase is also very limited, however. The trade-off between this group and the high-risk group, which worked so well in 1986 to keep total construction activity expanding, will still be working in 1987, but not as well.

Last year, the best part of the construction business to be in was one family homebuilding. (The best place to do it was in southern California, which was the locale of three of the nation's top ten homebuilding cities.) As contracting for commercial building sagged, one family housing—biggest of all the building markets—responded to favorable credit developments with a 20 percent increase. Falling mortgage rates attracted more than $14 billion of new construction demand in 1986, easily enough to cover the $5 billion decline of offices and apartments. But in 1987, when office and apartment building is expected to skid another 18 percent, one family homebuilding will be hard-pressed to come through with another

gain the size of last year's. Even with the support of lower mortgage rates and strong demographics, the 1987 potential for one family housing is more like a gain of 5 to 10 percent than last year's 20 percent.

Institutional building (schools, health facilities, public administration buildings) has been one of the pleasant surprise markets of the 1980's. Driven by demographics (school-age kids and oldsters, mainly) and financed by bonds (not much direct Federal funding anymore), institutional building has emerged from a long period of dormancy. With rising births (the "echo of the 1950's baby boom") and falling interest rates both reinforcing the educational building market, total institutional construction contract value has grown by more than 50 percent since the beginning of the 1980's—from just under $20 billion to its current $30 billion annual value. In 1987, when Federal deficit reduction (especially the cancellation of Revenue Sharing) indirectly adds stress to state and local government finances, temporary stability of contracting rather than continued expansion is the short-term outlook for this category of building.

Prospects for environmental construction (water resources, waste water treatment facilities) have brightened as a result of recent Congressional action. One of the first priorities of the new Congress was to reintroduce the Clean Water Act which had been vetoed by the President between sessions. Overwhelming Congressional support for this program assures a continuing flow of Federal (EPA) construction grants for the next several years while the transition is made to a revolving loan program.

Only a few months earlier, the previous Congress enacted the first major water projects bill in ten years, authorizing a total of 262 new Corps of Engineers projects with a combined value estimated at $16 billion. The appropriation of Federal funds on a year-to-year basis is on a collision course with deficit reduction targets, however. There is bound to be considerable resistance to Federal funding of public works by the Administration (which would opt for "user fees" and "local determination"), but the new solidarity of the Congress suggests that priorities concerning public works construction have taken a subtle change for the better.

Industrial construction merits inclusion among the "safe" building markets for 1987 only on the grounds that contracting isn't likely to sink any lower than its already depressed level. Recovery, which depends on improving trade balance to take up slack capacity, may be two years away.

The "Other" Group

The components of a third group of building types—retail buildings, hotels and motels, and transportation construction—have little in common except for the prospect of a 1987 decline of modest proportions.

Retail building is closely linked to the housing market. As is usually the case, strength in residential building, combined with general economic expansion, induced a high level of retail construction during the mid-1980's. And now, as housing starts recede in 1987 from their 1986 peak of 1.819 million units to 1.715 million, contracting for stores, shopping centers, warehouses, and other retailing facilities might be expected to slacken proportionately. However, because retail building was not entirely immune to the lure of tax shelters in the mid-1980's (although to a lesser degree than offices and apartments were), tax reform will cast its shadow on this market, too. In 1987, when the value of newly started residential building will be holding even with that of 1986, retail building is forecast to decline 5 percent.

In much the same way that residential building attracts stores and shopping centers, office building generates a derived demand for hotels and motels. Propelled by the office building boom, contracting for hotels and motels soared in the mid-1980's, but with the overbuilt office market already in retreat, hotel building can be expected to follow. In 1987, a decline of close to 10 percent would be consistent with developments in the office building market.

For political reasons, highway contracting is displacing office building as the construction industry's most immediate concern. Although Congress recently passed—by a large margin—a new highway bill to replace the Surface Transportation Act which expired last September, it is not at all certain that the President's veto of this $88 billion program can be overridden in the Senate. This has all the elements of a cliff-hanger because, after six months of temporary funding, the Department of Transportation has just about run out of carryover spending authority, and the once dependable highway construction market has become highly unstable.

Even if the veto is quickly overridden, the disruption of Federal funding that has already occurred will result in a loss of up to 5 percent of 1987's contracting potential. Further legislative delay would mean a larger decline of transportation construction than indicated in this *Outlook*.

How It All Adds Up For 1987

Now that the tax shelter balloon has been deflated, the overbuilt office and apartment markets face major corrections. As last year's 9 percent contracting cutback snowballs into an 18 percent decline for these two categories in 1987, the rest of the construction market lacks the capability to fill the void.

There is potential for a gain of as much as 8 percent in single family homebuilding this year, but that's where the potential ends, and it isn't quite enough. Even though a sizeable block of construction activity (institutional, environmental, industrial) will hold the line in 1987, another group of building types (retail, hotels, transportation) is headed for a decline of 5 percent.

Construction Contract Value
(billions of dollars)

	1986 Actual	1987 Forecast	Change: 1987 vs. 1986 Dollars	Percent
High Risk Markets	$ 52.4	$ 43.0	$ −9.4	−18%
Supportive Markets	133.8	141.5	+7.7	+6
"Other" Markets	57.5	54.6	−2.9	−5
Total Construction	$243.7	$239.1	$ −4.6	−2%

As the accompanying table shows, 1987's declining construction markets will slightly exceed the year's prospective gainers, leaving total construction contract value at $239.1 billion—2 percent short of the record 1986 amount. Allowance for a modest 3 percent increase of construction costs in 1987 means that *in constant dollars*, new construction activity will diminish by 5 percent this year, permitting some previous overbuilding to be absorbed.

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1987 Dodge/Sweet's Construction Outlook

Second Update
July 1987

Not Just Offices

The more you see of 1987, the less there is to like. This year started off well enough for the construction industry, with contracting for new projects still clinging to its peak 1986 rate of close to $250 billion. By midyear, the pace had slackened by $10 billion (annualized), and it isn't going to stop there.

During the first quarter, retrenchment in the overdeveloped office and apartment markets dragged construction activity down. Delayed highway legislation, which interrupted Federal funding, created a secondary complication. Then came April's credit tightening interest rates, which led to second quarter declines of one family housing and institutional building. Even though highway projects rebounded in the spring as the new Transportation Act unlocked the Highway Trust Fund, *total* construction contracting slipped back another notch as interest rates rose.

Earlier forecasts of 1987 construction contracting (issued in October and March) anticipated the inevitable weakness in offices and other commercial building this year as developers and investors adjust to tax reform. But as long as interest rates remained reasonably stable, there was reason to look for continued support from housing and institutional building. Experience of the first half of 1987 has borne out the bleak prospect for commercial building, but the recent volatility of interest rates now requires a re-evaluation of the industry's "safety nets."

Two That Are Quite Predictable

Commercial building (loosely defined here as the total of offices, shopping centers, warehouses, hotels/motels, and apartments) is now into its second year of decline as tax reform provides another reason to build less. The best reason: double-digit vacancy rates—the hangover that followed five years' celebration of the availability of real estate tax shelters. Six quarters of decline (commercial building peaked in 1985:IV at the extraordinary rate of 1.9 billion square feet) have reduced the start of new construction by 25 percent. But with so much space still reaching completion and spilling onto the market, vacancy rates have yet to recede.

The severity of the overbuilding malady varies widely, ranging from mild discomfort for shopping centers to acute indigestion for offices. All the commercial building categories share several common features, however.

- Overstimulation by the availability of accelerated depreciation since the Economic Recovery Tax Act (1981).
- Adjustment to full term depreciation as required by the Tax Reform Act (1986).
- Concentration of vacant space in the Sunbelt (and particularly in the Oil Patch).

The regional imbalance of the commercial vacancy problem is a mixed blessing. Despite a national average of close to 20 percent for office vacancies, demand remains reasonably strong in the Northeast and North Central states where building proceeded at a more moderate pace during the early 1980's when the South was booming. But with most of the vacant space concentrated as it is in less than half the country, its absorption will be a long and painful process.

In its second year of "the return to reality," the decline of commercial building has gathered considerable momentum, as expected. With offices leading the way, total commercial building (including apartments) is headed for a setback of 15 to 20 percent, following last year's 9 percent decline. Regional differentials in 1987 continue to point up the geographical diversity of the commercial building market. Contracting for offices, apartments, shopping centers, and hotels faces a decline of up to 25 percent in the South, but in the North-

east and the North Central regions, the reduction will be more like 10 percent. The West is vulnerable to a drop of 15 to 20 percent this year—close to the national average.

Public works construction (highways, bridges and mass transit; water resources and waste water treatment facilities) now looks stronger by almost a billion dollars than it did only a few months ago. The increase belongs in transportation construction, bringing the revised 1987 estimate to $24.9 billion—virtually even with last year's value rather than slightly below it as previously forecast. Reason for the current upgrade: the 1987 highway bill, which was still in legislative limbo at the time of the First Update, came through with more than had been anticipated. As Federal funds were released during the second quarter, above-average contracting just about eliminated the 10 percent shortfall that existed at the end of three months, and a strong second half under the new Federal program is in prospect. Environmental construction (water resources and waste water treatment) is currently on target at $14.4 billion, bringing total public works contracting to an estimated $39.3 billion, up 1 percent from 1986.

In a longer time frame three recently passed major legislative acts—the Water Resources Development Act (1986), the Clean Water Act (1987), and the Surface Transportation Assistance Act (1987)—together have established a new course for Federal funding of public works construction. Their provisions will soon reverse a recent decline of contracting for transportation and environmental projects as they provide a base of stability that extends well into the future. Because two of the three programs were passed by Congress over the President's veto, they indicate a change for the better in Federal priorities concerning the nation's infrastructure.

Two Others That Aren't

One family housing and *institutional building*, the construction markets that are the most sensitive to credit conditions, slipped from "safe" to "shaky" in the second quarter. As interest rates on mortgages and municipal bonds advanced sharply during April and May, contracting for both types of buildings fell approximately 5 percent from their strong first quarter rates. And because commercial building and public works construction are virtually locked into their current paths for the short run, these newly vulnerable parts of the construction sector will govern the outcome of 1987's second half.

1987 National Estimates
Dodge Construction Potentials

Second Update
July 1987

		1986 Actual	1987 Forecast	Percent Change 1987/86
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	287	225	−22
	Stores & Other Commercial	575	525	− 9
	Manufacturing Buildings	143	140	− 2
	Total Commercial & Manufacturing	1,005	890	−11
	Educational	116	112	− 3
	Hospital & Health	73	72	− 1
	Other Nonresidential Buildings	143	141	− 1
	Total Institutional & Other	332	325	− 2
	Total Nonresidential Buildings	1,337	1,215	− 9
Contract Value (millions of dollars)	Office Buildings	$ 22,007	$ 17,800	−19
	Stores & Other Commercial	23,099	22,150	− 4
	Manufacturing Buildings	7,039	6,825	− 3
	Total Commercial & Manufacturing	$ 52,145	$ 46,775	−10
	Educational	$ 10,523	$ 10,225	− 3
	Hospital & Health	7,887	8,050	+ 2
	Other Nonresidential Buildings	11,917	12,350	+ 4
	Total Institutional & Other	$ 30,327	$ 30,625	+ 1
	Total Nonresidential Buildings	$ 82,472	$ 77,400	− 6
Residential Buildings				
Dwelling Units* (thousands of units)	One Family Houses	1,081	1,050	− 3
	Multifamily Housing	755	600	−21
	Total Housekeeping Residential	1,836	1,650	−10
Floor Area (millions of square feet)	One Family Houses	1,730	1,702	− 2
	Multifamily Housing	738	591	−20
	Nonhousekeeping Residential	100	87	−13
	Total Residential Buildings	2,568	2,380	− 7
Contract Value (millions of dollars)	One Family Houses	$ 83,376	$ 84,700	+ 2
	Multifamily Housing	31,436	26,175	−17
	Nonhousekeeping Residential	7,312	6,525	−11
	Total Residential Buildings	$122,124	$117,400	− 4
Nonbuilding Construction				
Contract Value (millions of dollars)	Transportation Construction	$ 25,027	$ 24,925	—
	Environmental Construction	13,945	14,400	+ 3
	Total Public Works	$ 38,972	$ 39,325	+ 1
	Utilities	$ 2,126	$ 2,000	− 6
	Total Nonbuilding Construction	$ 41,098	$ 41,325	+ 1
All Construction				
Contract Value (millions of dollars)	Total Construction	$245,694	$236,125	− 4
	Dodge Index (1982 = 100)	156	150	

*F.W. Dodge basis.

Getting a fix on homebuilding and institutional construction requires some bold assumptions about the behavior of interest rates over the next several quarters. Is there a plausible explanation for tightening credit, as the Fed did in April, when the economy is burdened with excess capacity and the need to reduce the Federal deficit imposes the drag of fiscal restraint? There aren't many reasons that would justify the risk of tipping an already sluggish economy over the brink of recession.

A threat of severe inflation might be grounds for a round of monetary restraint, and there was a period in the spring when cost indexes moved up alarmingly. Supporting the sale of Treasury bonds in world financial markets could also be part of the explanation, since a higher interest rate is one way to offset the falling value of the dollar. But

1987 Regional Estimates
Dodge Construction Potentials

Second Update
July 1987

Northeast — CT, MA, ME, NH, NJ, NY, PA, RI, VT	1986 Actual	1987 Forecast	Percent Change 1987/86
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$ 9,433	$ 9,050	− 4
Institutional and Other	4,893	5,350	+ 9
Total	$14,326	$14,400	+ 1
Residential Buildings			
One Family Houses	$14,149	$14,225	+ 1
Multifamily Housing	6,130	5,375	−12
Nonhousekeeping Residential	1,200	1,100	− 8
Total	$21,479	$20,700	− 4
Nonbuilding Construction			
Transportation	$ 5,163	$ 5,000	− 3
Environmental	2,465	2,575	+ 4
Utilities	448	525	+17
Total	$ 8,076	$ 8,100	—
Total Construction	$43,881	$43,200	− 2

South — AL, AR, DE, DC, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV	1986 Actual	1987 Forecast	Percent Change 1987/86
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$18,574	$15,550	−16
Institutional and Other	11,608	11,375	− 2
Total	$30,182	$26,925	−11
Residential Buildings			
One Family Houses	$32,649	$31,200	− 4
Multifamily Housing	10,081	7,725	−23
Nonhousekeeping Residential	2,593	2,325	−10
Total	$45,323	$41,250	− 9
Nonbuilding Construction			
Transportation	$ 9,442	$ 9,400	—
Environmental	5,196	5,575	+ 7
Utilities	478	500	+ 5
Total	$15,116	$15,475	+ 2
Total Construction	$90,621	$83,650	− 8

North Central — IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI	1986 Actual	1987 Forecast	Percent Change 1987/86
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$11,052	$10,375	− 6
Institutional and Other	6,282	6,600	+ 5
Total	$17,334	$16,975	− 2
Residential Buildings			
One Family Houses	$14,190	$16,375	+15
Multifamily Housing	5,378	5,000	− 7
Nonhousekeeping Residential	1,204	1,100	− 9
Total	$20,772	$22,475	+ 8
Nonbuilding Construction			
Transportation	$ 5,476	$ 5,475	—
Environmental	3,387	3,400	—
Utilities	304	200	−34
Total	$ 9,167	$ 9,075	− 1
Total Construction	$47,273	$48,525	+ 3

West — AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY	1986 Actual	1987 Forecast	Percent Change 1987/86
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$13,086	$11,800	−10
Institutional and Other	7,544	7,300	− 3
Total	$20,630	$19,100	− 7
Residential Buildings			
One Family Houses	$22,388	$22,900	+ 2
Multifamily Housing	9,847	8,075	−18
Nonhousekeeping Residential	2,315	2,000	−14
Total	$34,550	$32,975	− 5
Nonbuilding Construction			
Transportation	$ 4,946	$ 5,050	+ 2
Environmental	2,897	2,850	− 2
Utilities	896	775	−14
Total	$ 8,739	$ 8,675	− 1
Total Construction	$63,919	$60,750	− 5

now, with the threat of inflation subsiding, and with the dollar stabilizing, the need for monetary restraint has lost its urgency. Having responded to these stresses in the spring of 1987 with a temporary tightening of credit, the Fed can soon redirect its monetary policy to the more fundamental goal of sustaining the economy's growth. An environment of budgetary restraint, weak business capital spending, and substandard growth, along with moderate inflation, is a prescription for monetary accommodation, not monetary restraint. The change of leadership at the Fed does not alter those basics.

If this interpretation of events is mostly on target, long-term interest rates should be close to their current peak by now. It is assumed that mortgage rates will top out during the third quarter in the range of 10¾ to 11.0 percent. After hanging there for another quarter, rates will recede through 1988 when political considerations may modify the Fed's fierce independence a bit.

How the housing market will react to this (hopefully) temporary flare-up of mortgage rates depends a lot on how potential borrowers perceive 1987's interest rate behavior. The initial response, which was revealed in May's statistics, consisted of a sharp decline of

new home sales and a modest cutback of one family housing starts. If potential homebuyers believe that mortgage rates will remain steady at their current level (or move higher), the best strategy —for those who can—is to proceed with buying plans as soon as possible. But if buyers expect lower rates in 1988, postponement of plans is the obvious thing to do. Either way, homebuilding will be lower in the second half of 1987 than in the first half, but the disruption to the housing market will be greater if buyers adopt a "wait and see" attitude.

Because it is necessary to anticipate buyer/builder *expectations* about interest rates as well as to predict interest rates themselves, forecasting second half 1987 housing activity becomes uncomfortably unscientific. With allowance for the fact that buyers who cannot postpone their purchases have the option of an adjustable rate mortgage, it is assumed that the extent of deferred 1987 demand for one family homes will not be more than 5 percent of the year's potential. After averaging close to 1,100,000 units (F.W. Dodge basis) during the first half of 1987, the annualized rate of housing starts will drop to an average of 1,000,000 units in the second half for a full year total of 1,050,000. Recovery to a rate of 1,100,000 units is likely before mid-1988.

For the *institutional building* market (schools, health care facilities, government buildings, etc.) higher municipal bond rates represent a second layer of financial difficulty in 1987—the first being the cancellation of Federal Revenue Sharing.

Since the early 1980's, when the demographics of the institutional group (especially the "5 and unders" and the "65 and overs") picked up momentum, contracting for these building categories has risen steadily from 250 million square feet (1982) to well over 300 million (last year). Educational building has been the pacesetter for the institutional group, climbing back above 100 million square feet in 1986 for the first time since the decade began.

Institutional building, which eased from a peak rate of 339 million square feet in last year's second half to 331 million in the first half of 1987, would seem to bear out the ominous tone of a recent survey by the National League of Cities. Nearly half of 545 municipalities polled said that the loss of Revenue Sharing would have a "significant effect on capital spending this year." In the second half of 1987, the recent boost of more than a full percentage point in municipal bond rates will be an additional deterrent to local government construction, pulling the rate of contracting below 320 million square feet by the final quarter.

The revised 1987 estimated total of 325 million square feet of institutional building will be the first setback since the decade-long decline of the 1970's was reversed several years ago.

Before and After

The most important revision to be made in this Second Update of the 1987 Construction Outlook concerns residential building. In previous editions, 1987 housing starts were forecast to decline to 1,715,000 units—the result of opposing movements in the single and multifamily markets. Favorable demographics and stable mortgage rates were expected to support a modest *increase* in single family demand this year while apartments went the way of offices. The second quarter's leap of interest rates changes that.

When interest rates go up, construction activity comes down. It's one of the axioms of the business, and 1987 is no exception. It is now forecast that as the average mortgage rate approaches 11 percent during the summer of 1987, potential demand for at least 50,000 dwelling units will be deferred, reducing total housing starts this year to 1,650,000—a decline of 10 percent from the 1986 peak.

The timing of the second quarter's boost of interest rates was unfortunate because it caught the construction industry leaning the wrong way—more dependent than usual on its credit-sensitive markets. Housing and institutional building had been providing valuable counterpoint to the deteriorating commercial building market all through 1986 and early 1987, but this support is now fading. If, as expected, the surge of interest rates proves to be short-lived, some of this year's lost potential (mainly one family housing) should be recovered in 1988 as rates retreat again. In the meantime, however, both nonresidential and residential building—for different reasons—will be shrinking in each of the remaining quarters of 1987, leaving only public works construction as a source of stability.

Back-to-back declines of total construction contract value in the third and fourth quarters will reduce the full year's total to $236.1 billion. Compared with earlier forecasts of 1987 contracting, which were based on more favorable credit assumptions, this "last look" at 1987 shows that the risk of decline has been heightened in the past few months from a negligible 2 percent concentrated mostly in commercial building to a more significant 4 percent affecting most types of building. Adjustment for a modest 3 percent inflation in construction costs this year means that in "real" terms, 7 percent less new construction will be started in 1987 than in 1986.

The regional variations on this theme of cyclical decline haven't changed much. The South (or more precisely, the Southwest) continues to be the area under greatest strain—the result of past overdevelopment and current economic distress. Nearly three-quarters of the expected $10 billion national decline of construction contracting in 1987 will occur in the South. The West, as usual, is behaving much like the national average—in this case, a 5 percent decline. The Northeast and the North Central regions, which were least caught up in the commercial building binge of the early/mid-1980's, offer the best prospects for 1987: down only 2 percent, and up 3 percent, respectively.

A Preview of 1988

Although this year's outlook for construction contracting has deteriorated due to an untimely surge of interest rates, prospects for 1988 are more promising. Assuming that rates subside to a level that is more appropriate to the economy's fragile condition, the demographic potentials of the construction sector should be better served next year. However, there's no avoiding the inevitability of yet another down year for offices, apartments, and other commercial building as the vacancy problem persists.

This suggests that 1988 could be what 1986 was for the construction sector, and what 1987 should have been—a match-up of strength in housing and institutional building with weakness in commercial building that leads to overall stability.

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